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Before the U.S. Surface Transportation Board

OCT 27 2011

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STB Docket No. FD 35506
Western Coal Traffic League—
Petition for Declaratory Order

Comments of the
U.S. Department of Agriculture

Edward Avalos
Under Secretary
Marketing and Regulatory Programs
U.S. Department of Agriculture
Washington, D.C. 20250

Date: October 28, 2011

Authority and Interest

The Secretary of Agriculture is charged with the responsibility under the Agricultural Adjustment Act of 1938 and the Agricultural Marketing Act of 1946 to represent the interests of agricultural producers and shippers in improving transportation services and facilities by, among other things, initiating and participating in Board proceedings involving rates, charges, tariffs, practices, and services.

The Department of Agriculture (USDA) represents U.S. farmers, agricultural shippers, and rural electric cooperatives; the vitality of their livelihood is our primary interest. The Board's current procedures allow railroad acquisition/merger premiums to be passed through to railroad customers and is expected to result in higher rail rates for grain and oilseed shippers, particularly for those distant from barge transportation and are thereby most reliant upon rail services. In addition, the Board's current procedures could unfavorably impact rail rates paid by utilities serving rural areas, resulting in higher rates for electricity than would otherwise be the case. Higher rail and electricity rates could increase farm production costs and reduce the economic vitality of rural areas without a corresponding beneficial investment in rail infrastructure.

U.S. Agriculture and Rural Electric Utilities Depend on Rail Transportation

An affordable and reliable transportation network is necessary to maintain the strength and competitiveness of American agriculture and our rural communities. Rail service is a particularly important part of that network for U.S. agriculture, because it is virtually the only cost-effective shipping alternative available for low-value, bulky commodities in rural areas that are distant from water transportation and markets.

Large volumes of grain and oilseeds are produced each year in the United States. American farmers produced more than 19.9 billion bushels of grain and oilseeds in 2009, weighing more than 564 million tons;¹ railroads originated 131 million tons (23 percent) of that total.²

Because many agricultural producers are located long distances from their markets, they are dependent on rail transportation, particularly wheat producers. Nine of the ten top wheat-producing States are more than 150 miles from barge transportation on the Mississippi River, which usually provides the strongest intermodal competition to railroads for the long-distance movement of grain to export ports and therefore moderates transportation costs. Unlike other agricultural shippers in the United States, wheat shippers in much of the Great Plains have no cost-effective transportation alternatives to railroads. The wheat produced in these areas moves long distances to domestic markets for processing and consumption or to coastal ports for export. Shippers in these regions have little direct access to inland waterway transportation and the distances involved can make truck transportation uneconomical. In addition, corn production has expanded westward into regions having less rail-to-rail competition.

Because coal plays such an important role in generating electricity, its costs—including delivery

¹ "Grains and oilseeds" includes barley, corn, oats, rice, rye, sorghum, wheat, and soybeans.

² Association of American Railroads, *The Rail Transportation of Grain*, Volume 7, July 2010.

costs—are reflected in the price consumers pay for electricity. The Powder River Basin of Wyoming and Montana produces 43 percent of the Nation's coal. This production is also far from river transportation, and competitive access to railroads is limited, raising issues about generating electricity at affordable prices, especially in rural areas.

USDA Comments

USDA offers the following comments on our perspective regarding the issues raised in this proceeding.

Rail and Electricity Rates for Rural America

USDA believes that allowing rail companies to pass along acquisition premiums could adversely affect the rail and electricity rates for rural America and farmers, and it should not be allowed. In the case of BNSF, it is the dominant railroad handling the movement of grain, hauling 45 percent of the carloads of grain originated in the United States during 2009.³ In addition, BNSF hauls 26 percent of the coal traffic by tonnage.⁴

The Board's current procedures allow railroad acquisition/merger premiums to be passed through to railroad customers. The estimated \$7.625 billion write-up of BNSF's net investment base, which increases BNSF's pre-acquisition net investment base by 30 percent, is expected to raise rail rates to agricultural producers and electric utilities serving rural areas. Shippers more dependent on rail are expected to have larger increases while other less dependent shippers may have little to no increase in rail rates. A large proportion of these higher rail rates would likely be borne by small agricultural shippers and rural electrical cooperatives, located on rural lines having less traffic density and distant from cost-effective competing modes of transportation.

Many agricultural commodities (grain and oilseeds) have a low value in proportion to their weight. The cost of rail transportation to market constitutes a large percentage of the on-farm price, with costs for certain movements being up to 40 percent of the delivered price. As price takers, farmers are not in a position to pass these costs along to consumers and must absorb increases in transportation costs. On the other hand, coal companies are often able to pass through cost increases to their customers, such as electric utilities who in turn raise prices to individual homes, farms, and rural communities.

USDA believes it is unfair to expect American farmers and rural communities to pay higher rates, which reduce their real incomes, because a large acquisition premium was paid for BNSF. For the rate increases that will likely occur from the pass through, farmers and rural communities are not expected to receive improved service levels or benefit from actual railroad investment in infrastructure. Paying for market driven increases in railroad input costs is legitimate, but that is not the case with a passed through acquisition premium. Instead, farmers and rural electric customers will be paying higher rates simply because of an arbitrary acquisition premium. Further, such premiums are not allowed in other high capital, monopolistic industries, and shouldn't be allowed for rail. Rail consumers deserve the same protections afforded consumers in other regulated industries.

³ Ibid.

⁴ Association of American Railroads, *Railroad Ten-Year Trends, 2000-2009*, 2010.

Revenue Adequacy and Distorting the Rail Rate Appeal Processes

Including the acquisition/merger premium in the capital asset base would artificially lower the return-on-investment as currently calculated by the Board, making one of the most profitable enterprises in the country appear to be revenue inadequate. Railroads could use the appearance of revenue inadequacy to justify further rate increases.

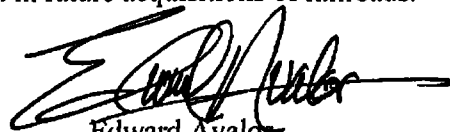
Allowing acquisition/merger premiums to be included in the net investment base inflates the railroad's Uniform Rail Costing System (URCS) variable costs, resulting in much lower revenue-to-variable cost ratios (R/VC) than would otherwise be the case. As a result, many shippers would be deprived of the right to appeal excessive rail rates as R/VC ratios could fall below the regulatory threshold of 180 percent. This would likely result in higher rail rates for grain and oilseed shippers and electric utilities serving rural areas, particularly for those most reliant upon rail services. In addition, the reduction in R/VC ratios would distort the results of Three-Benchmark, Simplified Stand-Alone Cost, and Stand-Alone Cost rate appeals, making successful rate appeals much more difficult.

Premium Pass-throughs Should be Discouraged

Allowing acquisition/merger premiums to be passed through to shippers encourages similar transactions in the future. It is possible that other investment companies watching this proceeding will see how easy it is to pass along premiums and could be encouraged to bid exceedingly high amounts to purchase another railroad. While in the past merger premiums may have been justified between two railroads due to synergistic cost savings and efficiency gains passed on to rail customers, there are likely to be little if any direct benefits to rail customers stemming from an acquisition premium. American farmers and rural communities should not have to pay for a merger premium each time a company decides to buy or sell a railroad.

Summary

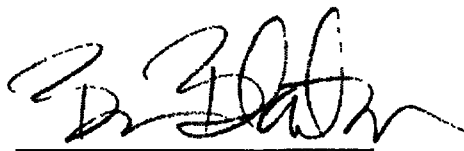
The issue of whether the Board allows railroads to pass through the costs of an acquisition or merger premium to rail customers is an important issue for agricultural shippers and consumers of rural electricity. USDA believes it should not be allowed. Such premiums should also not be allowed to affect revenue adequacy calculations or distort rate appeal processes. Finally, because this practice is not allowed for other industries, USDA believes the Board should change its policy to discourage this practice from being used in future acquisitions of railroads.



Edward Avalos
Under Secretary
Marketing and Regulatory Programs

CERTIFICATE OF SERVICE

I, Bruce Blanton, certify that on this 27th day of October, 2011, I caused a copy of the foregoing document to be served by first-class mail, postage prepaid, on all parties of record in STB Docket Number FD 35506.

A handwritten signature in black ink, appearing to read 'Bruce Blanton', is written over a horizontal line.

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